DOW THEORY LETTERS INC.

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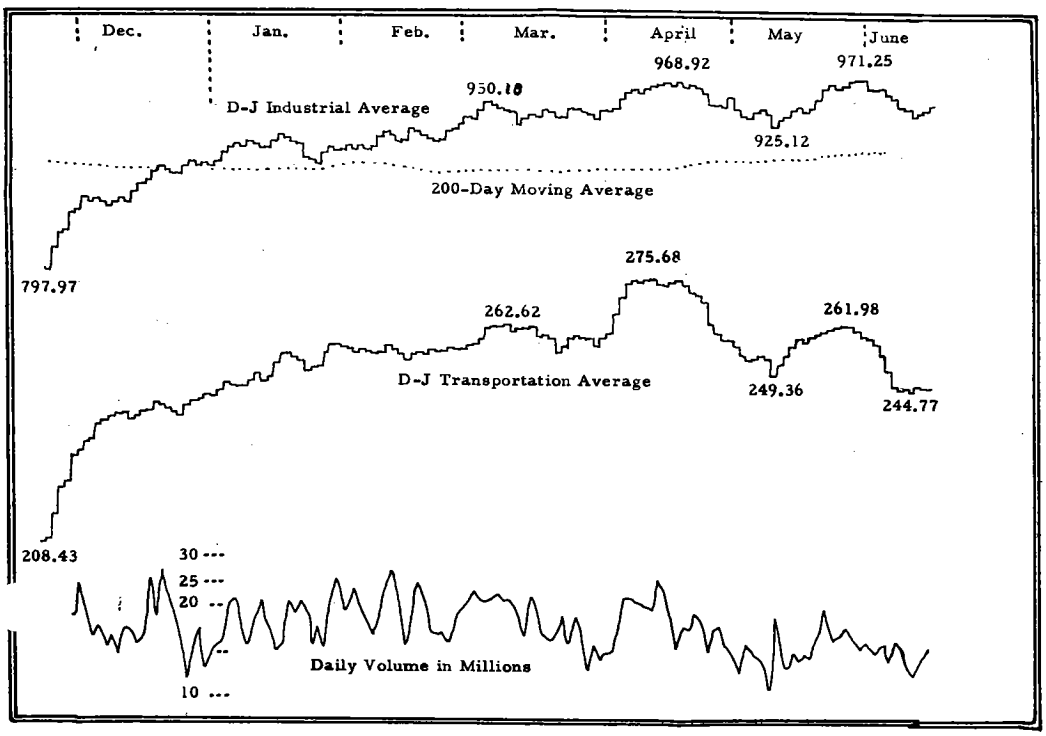
THE MARKET: As the year 1972 rolled in, I wrote that primary bear markets often record their highs in the first quarter, and that the lows are often seen in the third or fourth quarter of the year. I also noted that if this proved to be the case in 1972, it would be most interesting since a declining market at or near Presidential election time would hardly be calculated to "help" Mr. Nixon.

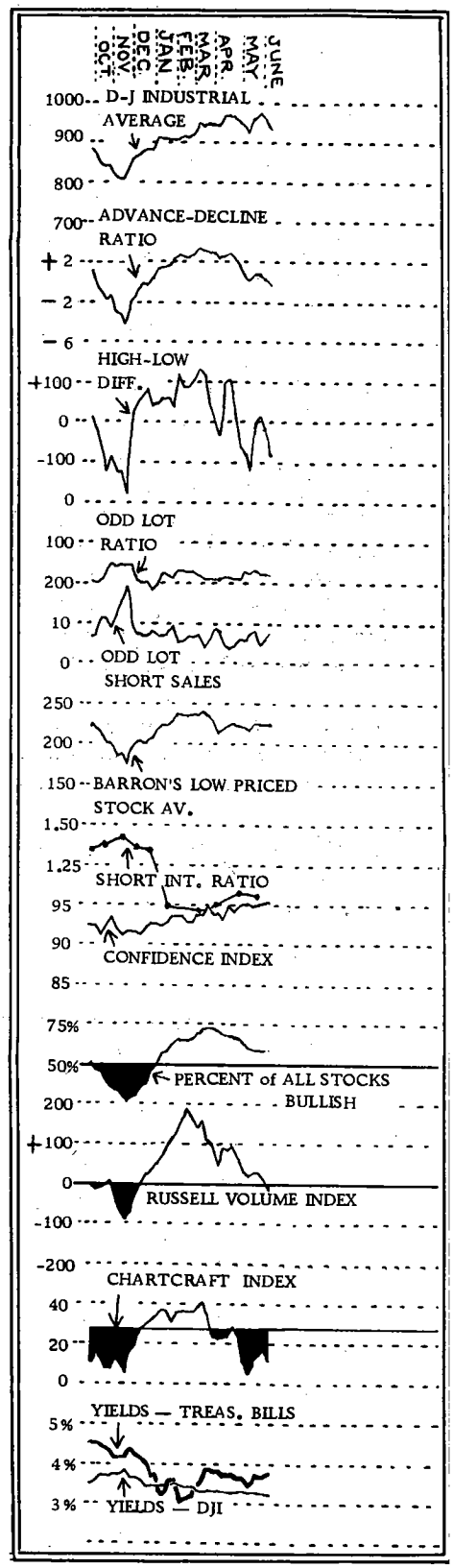
As we now know, March 9 represented the 1972 peak for the advance-decline ratio and therefore March 9 also marks the spot where the majority of stocks recorded their 1972 high levels. Since then deterioration has set in, and my original observation about primary bear markets hitting their highs early in the year is beginning to look rather accurate.

This presents a particularly fascinating picture for the rest of the year. For with the advent of technical deterioration, the odds suggest major trouble ahead. But trouble in the market is bound to affect Mr. Nixon adversely, and it is bound to help the man who will run against him (who appears to be Mr. McGovern).

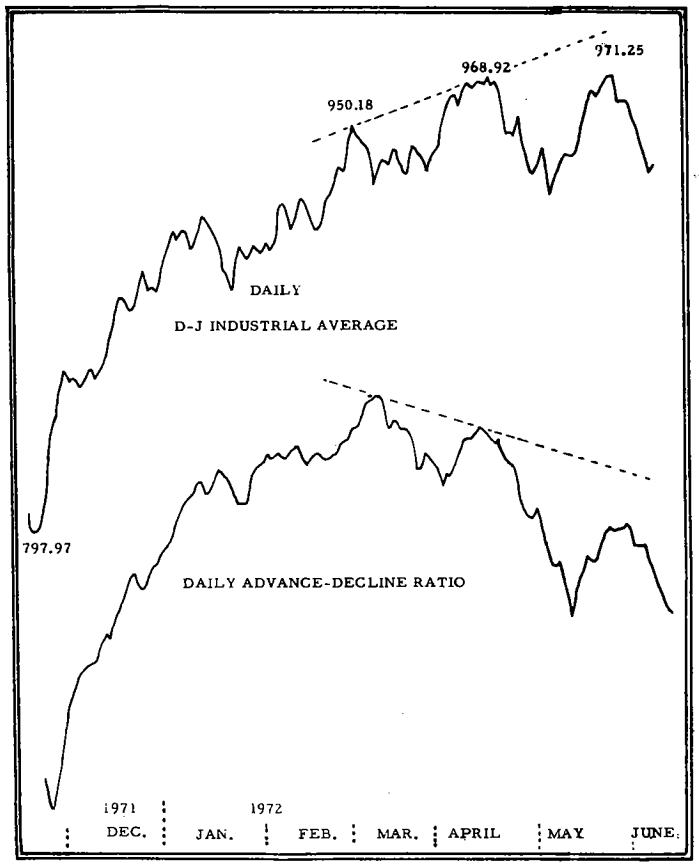
Now I don't care whether you like McGovern or not. There is one thing we have to face about McGovern, and that is that he is addicted to unorthodox "financial" plans and the possibility of his election could scare Wall Street to death. The irony of the situation is that any forthcoming major market decline will militate against Mr. Nixon and in favor of McGovern, and any trend in favor of Mr. McGovern will add impetus to a market decline.

In Letter 531 I presented a detailed account of the current dangerous price-breadth relationship. On page 2 of this report we can see that the Industrials, having risen to a third recovery peak of 971.25 (May 26), did indeed establish a "triple divergence" with the advance-decline ratio. The A-D ratio, as is clearly shown, recorded its own third descending peak on May 26. The strain of this flagrant "triple divergence" proved too much for the market, and a sharp sell-off ensued.





By June 9 the Utilities had recorded a new 1972 low of 106.63, the Transports halted at 244.77, exactly 1.63 points from their low for the year, and the A-D ratio slid to within a fraction of a new low for 1972. All of this means that the strength of the market now resides with the Dow Industrials. The Dow, despite weakness in the other indicators which we follow, is still well above its own 1972 low of 889.15.

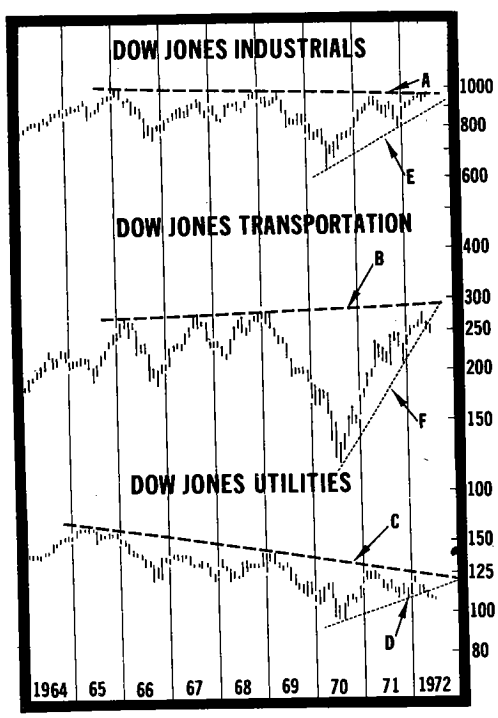


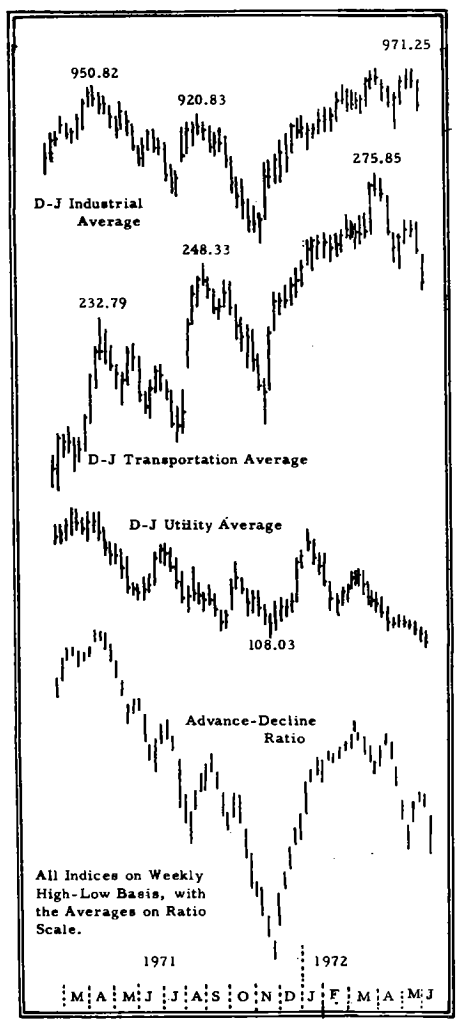
The Transports on the most recent decline (see page 1 chart) broke below their May low, and thereby wiped out almost all the gain of 1972. A comparable move on the part of Industrials would entail a cracking of the May 9 Industrial low of 925.12. Thus I would say that the critical point in the market now is the 925.12 level on the D-J Industrial Average. An ability to hold persistently above 925.12 will indicate that the Industrials are gathering strength for another possible recovery high (above 971.25). Conversely, a violation of 925.12 will suggest ominous and confirming weakness, and to me such a penetration would signify that the entire market is heading into a mess of major proportions.

TRENDLINES: While trendlines play no part in Dow's Theory, I nevertheless keep an eye on any obvious trendlines which appear to be forming. Comparative Market Indicators (P.O. Box 1557, Bellevue, Wash. 98009) included this neat little chart (bottom left) of the three D-J Averages, and by implication they agree with me that two of the three D-J components are showing weakness and breaking down.

Note the violation of Transport trendline F and Utility trendline D. Only Industrial trendline E stands unscathed, and as I said before, the strength of the market now lies solely in the power of Industrials to resist confirmation on the downside.

TECHNICAL VIEWS: Many of the indicators on the page 1 technical chart are worth studying. Note that the daily differential of new highs and lows has sunk into minus territory. More important it has been declining ever since March, despite new recovery highs in the Dow. This, of course, only confirms the





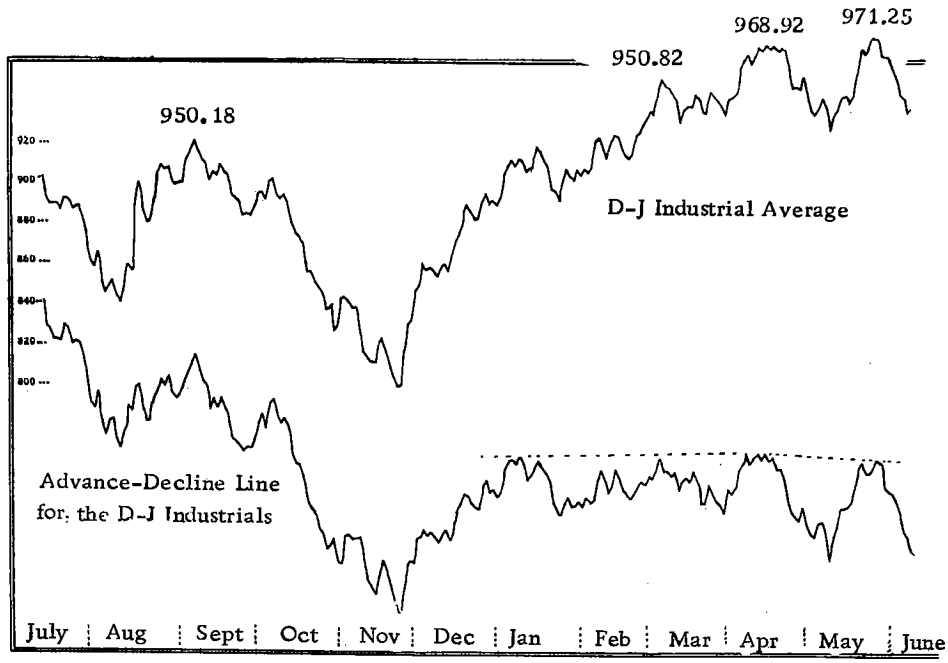
weakness which has been showing in the entire market as measured by the A-D ratio.

The Russell volume index has now dropped into minus territory for the first time this year. This means that the 60-day totals of down-volume have moved above the 60-day up-volume totals. Finally, Chartcraft's tally of 28 technical indicators has been bearish (black area) since May, a very negative reading on the market.

For my veteran technicians (who were brought up on Schabacker or "Technical Analysis of Stock Trends" by Edwards and Magee) you may have noticed the perfect "broadening formation" in the D-J Industrial Average and the "head-and-shoulders" top in the transports (they show clearly in the Wall Street Journal daily chart of the Averages). I will probably have more to say about these formations in a forthcoming Letter.

DOW ADVANCE-DECLINE RATIO: In recent Letters I have drawn attention to the A-D ratio of the 30 Dow stocks. This index is a running daily total of pluralities of advances or declines. For instance, if, on a given day 15 Dow Industrials advanced and 10 declined, the figure added to the previous day's total would be a plus 5.

Now the fascinating fact about the Dow A-D (see chart) is that it recorded its peak in early January. This was actually two months before the regular A-D ratio hit its peak (March 9). In April and again in May (see chart) the January Dow A-D peak was approximated, but never bettered.



This means to me that since January the strength in the Industrial Average has been very selective and much less impressive than it appears if we just follow the Industrial Average alone. Or to put it another way, the Industrial Average has continued up despite a March 9 peak in the majority of stocks as gauged by the regular A-D ratio. But a glance at the Dow A-D ratio indicates that breadth in the 30 Dow Industrials has been poor. And only a handful of Dow stocks have contributed to the "superior" performance of the Dow.

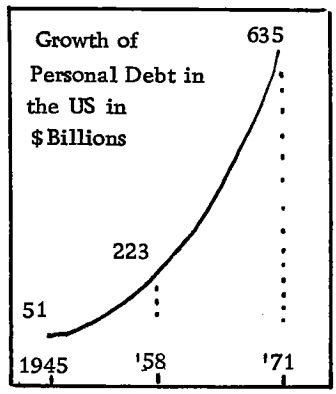
Tie this in with the record low in the Dow short interest ratio (see last Letter), and we get a picture of the senior Average which is far from impressive. I noted earlier in this report that the strength of the current market resides mainly in the Industrial Average. As this study shows, if the Industrials represent the "strength of the market," Wall Street is in trouble — as I believe it is.

GOLD, DEBT AND THE PIPER WHO MUST BE PAID: A few Letters back I quoted my friend Harry Schultz on the impending fate of the US, given its present trend. I said that I found Schultz's view a bit horrifying, but in the absence of any reversal of our present course, I simply could not argue with Schultz.

It was not without some surprise that a few days later I read this quote from Dr. Sicco Mansholt, the new President of the European Economic Community's Executive Commission (the statement is from a letter addressed to the outgoing President): "The United States is on the downward path, and it will be extremely difficult to save them from total collapse."

Then came a brutally frank discussion in which Mansholt writes: "If Europe follows a well-defined policy, it will be in a better position to impose a policy on the rest of the world as well, on the United States and Japan in particular." Mansholt added that if Europe did not follow a specific policy, its whole cause would go down the drain since "...the US does not possess the necessary political strength to guide the rest of the world towards the solution of this major problem."

In a nutshell, this shows me the kind of thinking that is going on at the top levels of Europe. They no longer trust the "head-in-the-sand" benign-neglect type of "thinking" which is coming out of the US. And they are seeking to protect themselves against what they believe could be a US collapse.



What is behind the fear of Europeans regarding the US and where it is heading? Part of this fear, of course, stems from the politically-inspired US mania for "growth," which is another name for spending one's head off in an effort to keep the incumbent politicians in power. I have written many times about the careening US national debt, and its frightening effect on the nation's liquidity. But now I want to comment on personal debt. Perhaps the accompanying chart will provide a picture of what I am so dismayed about.

From $51 billion in personal debt in 1945, the personal debt of all US citizens climbed to a record $635 billion as of January 1, 1971. This sky-rocketing of debt is having most obvious repercussions in the bankruptcy market. In 1950 personal bankrupcies averaged 27 per 100,00. By 1960 they had jumped to 87, and by 1970 they leaped to 161 per 100,00.

In other words, the average American is now in hock "up to his ears." And from another direction (besides his own debt) it can be noted that the US citizen is being squeezed. This is the area of taxes. The latest statistics show that the average American spent the first four months and ten days of 1972 earning the equivalent of all the taxes he must pay this year. Here is another amazing statistic. It now takes all the taxes on individual earnings of $10,000 and under just to pay the interest on the national debt. In other words, the results of a quarter of a century of reckless individual and public spending are now beginning to hit home — and hard.

On the trade front the story is little better. In April of this year the United States trade balance set the second largest deficit on record, and by all accounts we will see a record trade deficit for all of 1972. This despite a 1971 devaluation which was supposed to make US goods more competitive in world markets, while handicapping foreign goods. Of course what has happened is that imports have been coming in record quantities, regardless of price increases.

The test of a nation's financial strength is the strength of its currency. Thousands of years of history demonstrates that the rise of great nations can be measured by the rise of their coinage (and currency). By the same token, the demise of great empires have always been foreshadowed by the demise of their coinage. Such deterioration always consists first of decreasing the size or altering the content of the gold coin, then substituting silver or some other metal for gold, and finally substituting a base metal for both silver and gold while issuing government edicts to the effect that the new base metal coin is legal for payments and constitutes the coin of the realm.

Another way of putting it is that gold goes to the strong. The rise of the Roman Empire, the Spanish Empire, the Dutch Empire, the British Empire, the America of the early 20th century were all accompanied by a vast build-up of gold in their respective coffers (much as gold is building up in Europe and Japan today). Gold is the ultimate repository of wealth, the barometer of the productive power, the will to thrift and discipline and the measure of "success" of a nation. There is no arguing with gold; its movements are remorseless and unemotional (as the US, to its sorrow, is now finding out).

Thus we come to the story of 1972. And the world stands amazed as the price of gold on the free market rockets up in the face of years of denials, ridicule, rumors and threats on the part of four US Administrations. The gold rise is saying one thing loudly and clearly, "The US has squandered its power, it has used it unwisely, it has been following wrong goals, it has bled its strength dry in fruitless pursuits. Now the piper must be paid. And it cannot be paid in US dollars, because the dollar's strength has been sapped. When men become disillusioned with a reserve currency (or for that matter with any currency), they either swap the weak currency for a strong one or swap their currency for gold. And that is what we see happening today."

Meanwhile, gold is exerting its power on the Washington structure. A few weeks ago, Treasury Secretary Connally left his post (just before the almost vertical rise in the price of gold). As I write this, rumor has it that Treasury Under-Secretary Volcker (another rabid anti-gold man) is going to resign, with the further rumor that a deal for a much higher-price for gold was made by Mr. Nixon in Russia. The "new gold price" is, naturally, to be announced "after the election." The question is, will gold and the world wait patiently for the election to come and go? Will the market wait? I wrote many months ago that markets do not wait for men, they do not wait for elections, they move when they are ready, regardless of the "best laid plans."

SILVER: "Gold is the rich man's precious metal; silver is the poor man's precious metal." Old adage uncovered by peripatetic prophet Dr. Harry Schultz. "If gold goes up, can silver be far behind?" New adage coined by Richard Russell, with an answer ... "Yes, but probably by not more than a year or so."

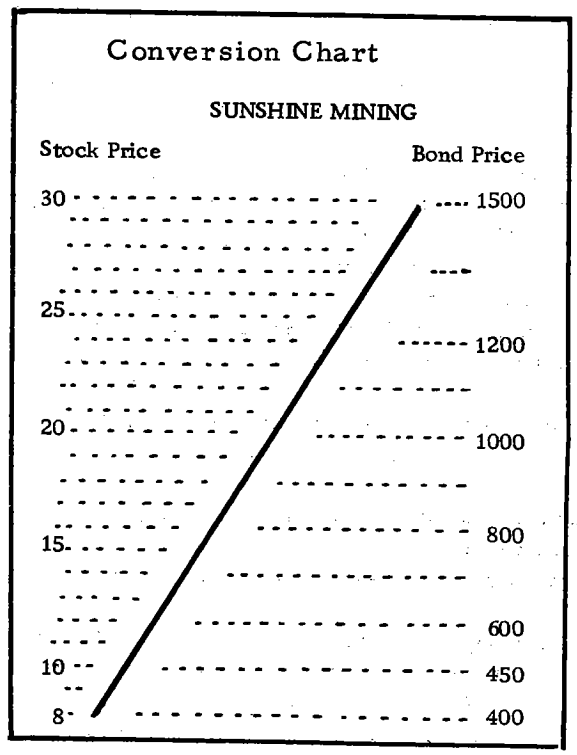
Few people are aware that there is a convertible bond situation in precious metals. This is the Sunshine Mining (SSC) convertible subordinate debenture, the 6½'s of 1989. These bonds constitute a $20 million dollar issue, and they are subordinate to all present

and future debt called senior debt. The only present senior debt is $1.1 million. But the convertibles are, of course, senior to the present common stock of SSC.

The convertibles are redeemable on 30 days notice at 106 (this means $1060) beginning April 14, 1972, and the price of the redemption dropping .5% annually thereafter until 1984. The convertibles may be redeemed at 100 (par) plus accrued interest in 1979.

The convertible has a coupon of 6½%, and the bond now sells on the market at around 80. That means that the bond affords a fairly interesting yield of 8% at today's price. The bond is rated B by Standard & Poor which is a "fair" rating but not a good one.

The SSC convertible was issued in January, 1969. Since then it has been as high as 107 3/4 in 1969 and as low as 70 in 1970 and as low as 74 this year. I have drawn a chart showing the conversion ratio. For instance, with the common stock selling at 8 (and it is about there now) the convertible (forgetting the yield, which is holding it up now) is worth only 400. At 16 on the common, the bond is worth 800. If the common goes to exactly $19.46 the bond will sell at par (1000), which means that each bond is convertible into 51.39 shares of stocks.



What does all this mean? It means that the SSC convertible is a fair risk as a straight bond, and will yield 8% now and could go up strictly on a yield basis if the general yield level of the bond market drops. In other words, the buyer does get paid for "sitting" with this bond, even if SSC common or silver stocks in general never get off the ground again. This would be the main advantage of buying the SSC convertible as a hedge on silver, rather than say the common stock of most silver mines, which are now yielding very little.

I do not have room here to go into all the ramifications of Sunshine, but suffice it to say that the price of silver is now very depressed, and there is a good chance that silver could go a good bit higher. One of the reasons is high consumption of silver, although it should be remembered that silver consumption has always been based on the trend of the economy. In booms, silver consumption booms, in depressions silver consumption drops off.

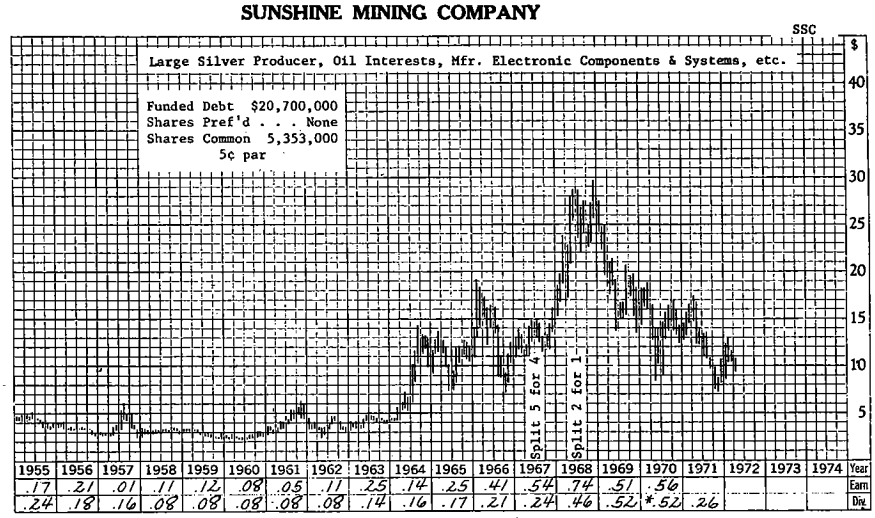
Silver, in the past, has been a "monetary metal" or a "store of value metal." In other words, people have used silver somewhat as gold, in that it possesses a certain intrinsic value. At many times, silver was used as money, and it was not so long ago that the US used silver in its coins. This could happen again.

Finally, historically, silver tends to move up when the price of gold moves up. A few years ago gold was selling at $35 per ounce and silver was over $2.50 per ounce. Now gold is over $50 per ounce and silver is $1.60 per ounce. On this basis, silver appears "cheap." Theoretically, with gold at its current price, the price of silver could double. At many times in history, the gold-silver price ratio was 15 or 16 to 1. If that were to happen again silver would sell at over $3.00 today, based on the price of gold.

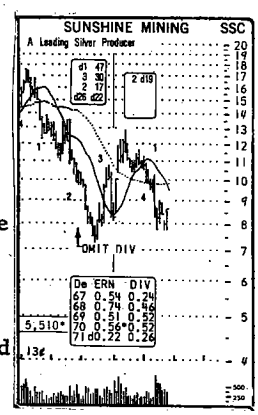
Back to SSC common stock, which is the "kicker" behind the SSC convertible. Obviously, the main determiner of profits in SSC common is the trend of silver prices (although the company is now diversifying). At present, silver is depressed, and SSC common is very depressed. On top of this, the very recent mining disaster at SSC has probably depressed the stock.

To show just how depressed SSC is, I am including a long-term monthly chart (page 6) of the common going back to 1955 (chart courtesy of M.C. Horsey, Salisbury, Md. 21801). Note that there is a good and well-tested base in SSC at 7, a level which has held on all sell-offs going back to 1965, 1966, 1970, 1971 and this year. My guess is that 7 will hold over the foreseeable future, and that the stock will probably hold at or above 7 prior to its next rise. I am including a weekly chart to show this year's action in SSC, and here it is clear that despite the low price of silver and despite the great mine disaster at SSC, the stock has again held above 7 (chart courtesy of Quote Digest, P.O. Box 213, Wichita, Kans. 67201).

What has SSC got going for it now? First, I feel that there is a good chance the price of silver will move up, particularly in view of the inflation of currency and the great interest in gold. Gold interest usually spreads into silver, although this has not yet been reflected in the price of silver. Second, the common stock of SSC is now very depressed, actually near a 9-year low. This has depressed the SSC convertible, despite its 6½% coupon.


SUNSHINE MINING COMPANY
SSC
Large Silver Producer, Oil Interests, Mfr. Electronic Components & Systems, etc.
Funded Debt $20,700,000
Shares Pref'd . . . None
Shares Common 5,353,000
5¢ par
Split 5 for 4
Split 2 for 1
1955 1956 1957 1958 1959 1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 Year
.17 .21 .01 .11 .12 .08 .05 .11 .25 .14 .25 .41 .54 .74 .51 .56 Earn
.24 .18 .16 .08 .08 .08 .08 .08 .14 .16 .17 .21 .24 .46 .52 *.52 .26 Div
* and small stock div.

Technically, the SSC is now an interesting situation. The common has sold off from a 1968 peak of just under 30 to a 1972 low of just over 7. This is a 22 point drop. Normally (unless a company is directly going bankrupt) there is a 50% correction of every major move. This means that there could be a "normal" correction in SSC back to around 18. If that occurs, the convertible could easily sell near or above 100.



However, there is a dilemma. If one buys the SSC common here and the common goes to 18, you have better than doubled your money. But if one buys the convertible (which does yield 8%) and the common goes to 18, you will show an appreciation of about 25% (plus interest on the convertible). Which is the better play, the convertible or the common? There is no answer, for it depends on your psychological make-up and your needs. A retired speculator who likes a return on his money might prefer the convertible even though appreciation possibilities are less attractive. A "silver bug" might well prefer the greater leverage of the common.

As to the merits of the company itself, I simply do not have room here for a complete analysis of SSC, and I refer you to your broker or to the write-up issued by Standard & Poor's or by other organizations.

One last happy thought on the convertible. If the common should go back to its 1968 peak of 29 3/4, the convertible could sell near 150 (see conversion chart). This would be almost double the current market price of the bond. If, if, if, and that's of course part of the dream of every market speculator.

LATE NOTES: As this is written, the Dow is obviously making a serious attempt to correct on the upside, the first real advance since the end of May. With so many indicators "out of whack," I can only conclude that further distribution will go on under the guise of a "Dow that wants to give Mr. Nixon a present of 1000 by election time." Caveat emptor.

The gold-silver chart below is probably worth more than all the claims and denouncements which we hear almost daily about the precious metals. The chart deals with unemotional price movements, and the price of gold has been heading "through the roof." So far and during all of 1972 the upward price moves in gold have been violent, the downward corrections weak and rather short. What is extraordinary, so far, is not that gold has slipped back from its high of just under $65, but that the decline has been so grudging and shallow.

The fact is that gold demand continues insistent, industrial use of gold continues to climb, and it is simply a matter of how far users, monetary officials and speculators are willing to push the metal before they step back, hoping for a decline so that they can pick up a further supply at price concessions.